WEEKLY ECONOMIC COMMENTARY

24 Jun 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

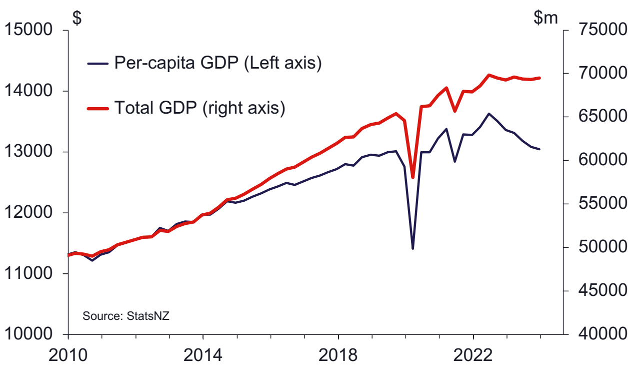
Activity off the boil while inflation simmers

The latest GDP figures revealed that economic growth in the early part of the year was a touch firmer than we had expected. However, that's still left us with a picture of weak economic activity, and recent indicators point to ongoing softness through the middle part of this year. Questions remain about the persistence in inflation and what that means for the RBNZ's future policy stance.

New Zealand's economy grew by 0.2% in the March quarter. While that's certainly not strong growth, it was ahead of the 0.2% contraction that we had been expecting. It also means that New Zealand has narrowly avoided slipping back into recession.

But whether-or-not we are technically in recession doesn't really tell the whole story. Stepping back from the normal quarter-to-quarter swings, the longer-term trend in economic activity remains weak. Over the past 18 months economic growth has stalled, with the level of activity effectively tracking sideways. And even that flat result has been flattered by strong population growth – in per-capita terms, economic activity has fallen 2.4% over the past year.

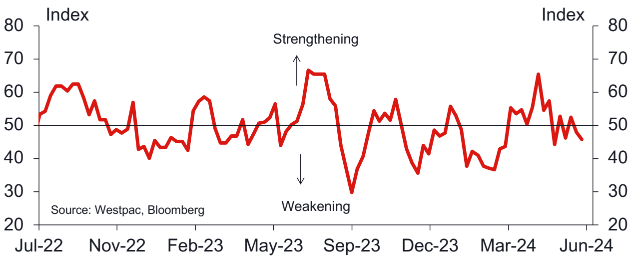
The New Zealand economy is treading water



Key views

	Last 3 months	Next 3 months	Next year
Global economy	→	→	↗
NZ economy	→	→	↗
Inflation	↘	↘	↓
2 year swap	→	→	↘
10 year swap	→	→	→
NZD/USD	→	→	↗
NZD/AUD	→	→	↘

Westpac New Zealand Data Pulse Index



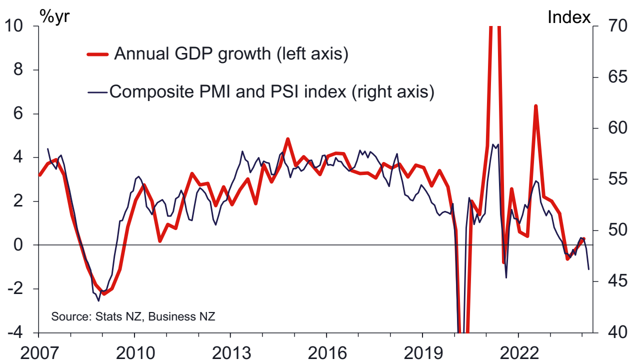
Key data and event outlook

Date	Event
2 Jul 24	NZIER QSBO survey, June quarter
4 Jul 24	Govt financial statements for 11 mths to May
10 Jul 24	RBNZ OCR Review
11 Jul 24	NZ Selected price indexes, June
17 Jul 24	NZ CPI, June quarter
31 Jul 24	FOMC Meeting (Announced 1 Aug NZT)
6 Aug 24	RBA Monetary Policy Decision & SMP
7 Aug 24	Labour market statistics, June quarter
8 Aug 24	RBNZ Survey of Expectations, June quarter
14 Aug 24	RBNZ OCR Review & Monetary Policy Statement
15 Aug 24	NZ Selected price indexes, July
12 Sep 24	NZ Selected price indexes, August
18 Sep 24	FOMC Meeting (Announced 19 Sep NZT)
19 Sep 24	NZ GDP, June quarter

The weakness in growth reflects the impact of some powerful economic headwinds. Most notably, continued high inflation and high interest rates are constraining both household spending and business activity. Soft demand in some of our key trading partner economies is also weighing on export earnings.

More recent economic data indicate that growth has remained subdued as we've moved into the middle part of the year. In the household sector, **our latest survey of consumer sentiment** showed that spending appetites have continued to weaken as the public comes to terms with the RBNZ's message that rate cuts are some way off. Similarly, in the business sector the latest PMI and PSI reports have highlighted subdued sales and orders, with notable weakness in the services sector. Soft demand and continued pressures on businesses' margins have been a consistent theme in our own discussions with businesses in some of New Zealand's regional centres recently.

Real GDP vs composite activity indicator



We expect that growth will remain subdued over the remainder of this year. However, we do need to put the current downturn into context. The slowdown that we're now seeing follows a period of rapid growth in the wake of the pandemic. In part, that was due to pent-up demand after the lockdowns. But what really lit a fire under demand was record low interest rates and expansionary fiscal policy. Those conditions pushed the economy well beyond sustainable levels and saw inflation surging to multi-decade highs.

Demand is now moving back into better alignment with the economy's supply capacity. That seen most clearly in the labour market: while unemployment has risen from the record low of 3.2% that we reached in 2022, at 4.3% it's currently around average, rather than elevated levels.

Furthermore, even with the downturn in demand, we're still not spending within our means. We're still running a current account deficit of 6.8% of GDP, a level typically more associated with an overheated economy, not one in recession. Of course, there are several reasons why this deficit has blown out – tourism earnings haven't fully recovered from the Covid shock, outbound travel is still in a catchup phase after the border closure, and global inflation has ramped up the cost of our imports. But these just reinforce the point: as a nation, we've taken a big hit to our international purchasing power, but we haven't adjusted our spending habits to reflect this.

Importantly, although growth is cooling, New Zealand is still grappling with some strong inflation pressures. Overall consumer price inflation is running around 4%, with domestic prices (aka. non-tradables inflation) up 5.8% over the past year.

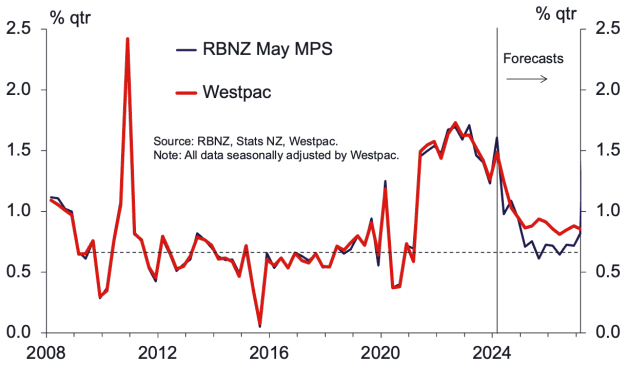
Those lingering domestic inflation pressures were the focus of a **recent speech from RBNZ Chief Economist Paul Conway**. The speech noted that *"There are some reasons to think that inflation may be more persistent than in our current projections in the near term."* That's because many components of domestic inflation have been 'sticky'. In fact, outside of the construction sector, non-tradables inflation has shown scant signs of cooling even with the sharp slowdown in growth that's occurred over the past 18 months. Notably, those price rises are not limited to items like council rates or insurance. Instead, domestic price pressures are widespread, which is something the RBNZ can't look through.

We agree with the RBNZ's assessment about the strength of the near-term inflation outlook. We've frequently highlighted that inflation pressures are strong and widespread. And our forecasts for this year are in line with the RBNZ's projections.

Where there is more uncertainty is the medium-term outlook for inflation, and on this front, the RBNZ has noted some reasonable questions about how inflation pressures will evolve. The RBNZ noted that there are *"some reasons to think that inflation could fall more quickly than expected over the medium term."* That includes the emergence of spare capacity in goods markets and the labour market which could dampen inflation. The RBNZ has also highlighted the role that easing inflation expectations could play in helping to pull down inflation.

As noted above, we've already seen a cooling in the labour market, and we expect that will continue over the coming year. Combined with softening demand, that has already resulted in inflation in some discretionary spending areas cooling. However, we need to see more adjustment in pricing in the services sector, which may take a while as the total pull-back in output in the last 18 months has been relatively modest – albeit prolonged. At the same time, we still expect continued stickiness in areas like government charges (like rates) and insurance – something that is not factored into the RBNZ's forecasts beyond the very near term. That means the RBNZ could be surprised to the upside in relation to domestic inflation over the medium term.

Non-tradables inflation slowing, but sticky underlying pressures



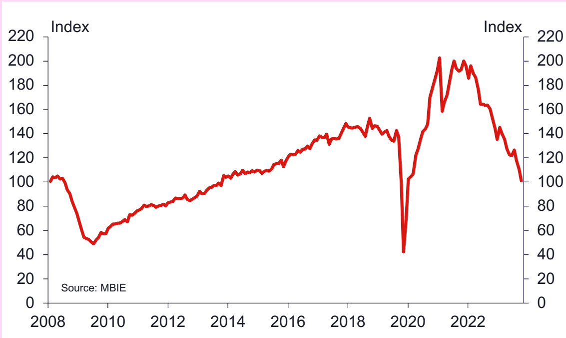
Bottom line, with the RBNZ signalling upside risk for inflation in the near-term, we think they're unlikely to ease their foot off the brake soon even with growth slowing (in contrast to market pricing for earlier rate cuts). Consistent with that, the key sentence in the speech noted that the RBNZ still expects that *"a period of restrictive policy is necessary to give us confidence that inflation will return to target over a reasonable timeframe"*. This is not a different position than the RBNZ took in May. We don't see that shifting in July either.

Satish Ranchhod, Senior Economist

Chart of the week.

Job advertisements have continued to slide this year, as firms' struggles with labour shortages have receded into the rearview mirror. The number of job ads in May fell to its lowest level in 10 years, an even starker decline when considering that the labour force has grown by more than a quarter in that time. Ads for highly-skilled roles have held up better than the rest, but the decline has been widespread across regions and industries. While employers appear to be largely holding on to their current workers, they are clearly not in expansion mode.

Online job advertisements

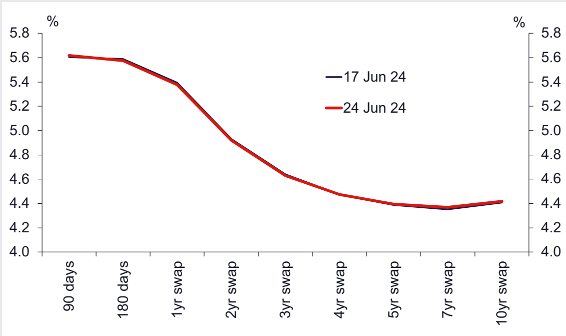


Fixed versus floating for mortgages.

The RBNZ left the OCR on hold in May and signalled that rate cuts are stills some way off. Westpac is not forecasting OCR reductions until early 2025.

For borrowers favouring certainty, at current fixed rates we see value in fixing for as long as two years.

NZ interest rates



Global wrap

Last week provided more evidence of the diverging fortunes of central banks globally. Those who have made more progress in bringing inflation down have been able to start reducing interest rates or are close to doing so. For those who have had less success, it appears that interest rates will need to remain high for longer, and even further hikes can't be ruled out.

Asia-Pacific.

The Reserve Bank of Australia left its cash rate unchanged at 4.35% as expected. However, the accompanying statement and press conference showed that the RBA is becoming more alert to upside inflation risks and is less confident that inflation will move sustainably towards the target within a reasonable timeframe, based on current policy settings. Wednesday's monthly CPI indicator will provide an important update on how services inflation is unfolding. We expect a flat result for May; with a -0.4% from last year dropping out, this would see the annual inflation rate rise from 3.6% to 4.0%.

Europe.

The Bank of England kept its policy rate steady at 5.25% in a 7-2 vote but gave the first hint of a rate cut in the near future. Economic conditions were viewed as consistent with progress being made on inflation, with a number of those who voted for no change noting that their decisions were "finely balanced". The decision came a day after the release of the May CPI, which saw the headline rate reach the 2% target. However, core inflation was 3.5%y/y while services inflation remained sticky at 5.7%y/y.

The Swiss National Bank delivered its second rate cut this year, pointing to lower inflation forecasts and a rising Swiss franc in the face of growing political uncertainty in Europe. In contrast, Norway's central bank delivered a 'hawkish hold', signalling that rate cuts are unlikely this year. Signs of improved activity and stronger wage growth were seen as extending the time it would take to bring inflation back to target.

US.

FOMC speakers again emphasised the prudence of waiting for further progress on inflation's return to target. That said, it was evident in their remarks that this view was predicated on US growth remaining above trend and no further slippage in the labour market. Data last week instead highlighted the downside risks for activity, with retail sales softer than expected in May, rising just 0.1%. Housing data was also weak in May, with starts now 20% lower than a year ago and permits down 9%y/y.

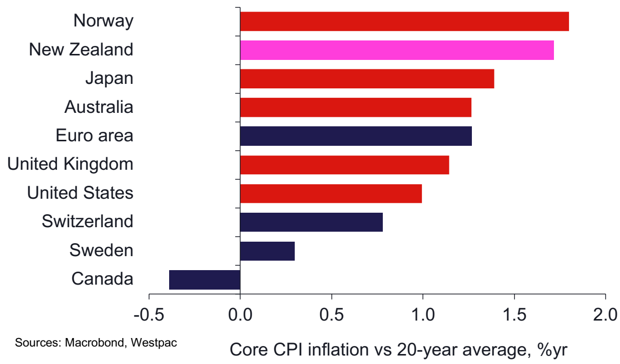
Trading partner real GDP (calendar years)

	Annual average % change			
	2022	2023	2024	2025
Australia	3.8	2.1	1.6	2.3
China	3.0	5.2	5.2	5.0
United States	1.9	2.5	2.5	1.5
Japan	1.0	1.9	0.5	1.0
East Asia ex China	4.5	3.3	4.2	4.2
India	7.0	7.8	6.9	6.7
Euro Zone	3.4	0.4	0.6	1.5
United Kingdom	4.3	0.1	0.5	1.3
NZ trading partners	3.2	3.4	3.4	3.4
World	3.5	3.2	3.2	3.0

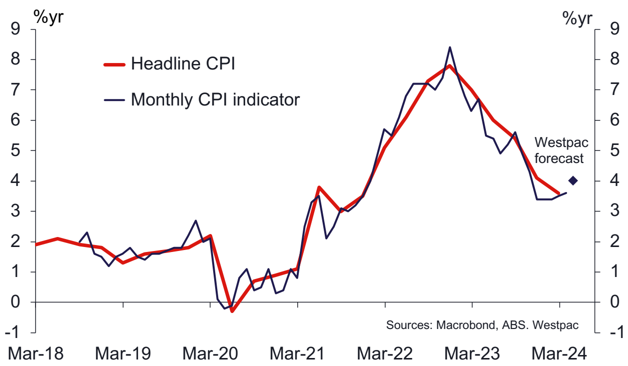
Australian & US interest rate outlook

	21 Jun	Jun-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	4.10	3.10
90 Day BBSW	4.41	4.37	4.17	3.30
3 Year Swap	4.10	4.20	4.00	3.50
3 Year Bond	3.94	4.00	3.80	3.30
10 Year Bond	4.24	4.35	4.25	4.00
10 Year Spread to US (bps)	-2	-15	-5	0
US				
Fed Funds	5.375	5.375	4.875	3.875
US 10 Year Bond	4.26	4.50	4.30	4.00

Global core inflation vs long-run average



Australian CPI inflation



Financial markets wrap

Interest rates.

NZ swap rates fell slightly last week, led by US yields which fell mainly due to risk aversion emanating from the looming French election (where far right and left parties are polling well above the incumbent centrist party).

NZ GDP data for Q1 was marginally stronger than expected, but it had little impact on markets, with global sentiment, which is biased towards lower interest rates, dominating. Adding to that sentiment was the Swiss central bank, which cut its policy rate for the second consecutive time in this cycle, and the Bank of England, which shifted its stance towards a possible August easing.

This week's key event will be the US PCE inflation data on Friday, with any surprises likely to ripple to NZ's rates market. We will also be watching NZ's monthly consumer and business confidence surveys, released on Thursday.

The NZ 2yr swap rate is currently at 4.92%, the 4.90% support area holding last week after a second attempt in a month to break lower. We suspect fresh economic news will be required to cause a meaningful downward shift in yields, since market pricing is arguably stretched, at a 50% chance of a cut in October, and over 100% for November. We expect the first cut to be in February 2025. That said, any surprises causing rates to rise will be seen as an opportunity to receive by speculators persistently biased to betting on lower rates.

Foreign exchange

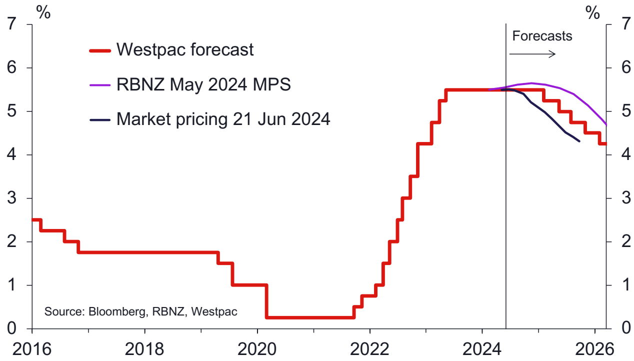
NZD/USD, similarly to many other USD crosses, has been rangebound, between 0.6100 and 0.6220 over the past six weeks. Unlike some others such as AUD/USD, though, the downside looks vulnerable near term.

The US dollar has rebounded in June, partly due to mixed US economic data and partly due to global risk aversion related to the French elections and the resultant flows into the 'safe haven' USD. That theme is likely to persist this week, with the French election starting this weekend. Data wise, USD markets will focus on the US PCE inflation data on Friday.

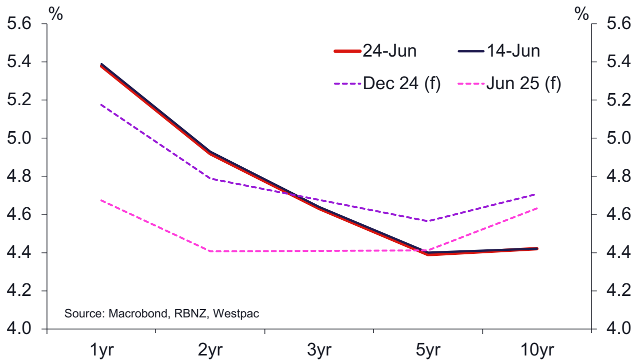
Our multi-month forecast remains modestly bullish, targeting 0.6300 in Q3. However, that is conditional on our forecasts for the Fed and RBNZ (easing to start in September 2024 and February 2025, respectively). We see the main risk to this outlook being a delay in the Fed's easing cycle, in which case NZD/USD would sit closer to 0.6000.

NZD/AUD has reversed lower, mainly due to the RBA's hawkish hold last week, where the Board expressed concern about sticky inflation. Currently around 0.9200, there's potential to fall further to 0.9150 this week on yield spread momentum.

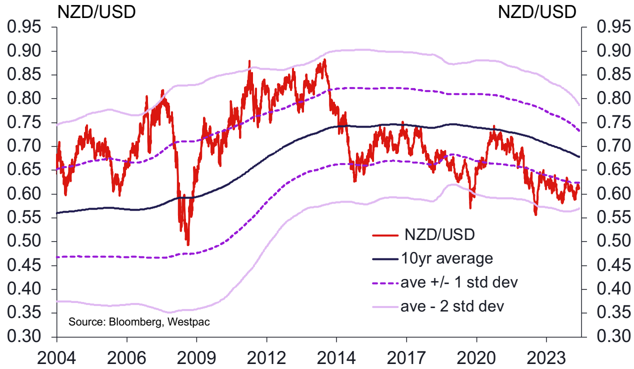
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-24
USD	0.612	0.586-0.620	0.555-0.743	0.647	0.61
AUD	0.922	0.907-0.929	0.873-0.992	0.931	0.91
EUR	0.572	0.552-0.573	0.517-0.637	0.582	0.55
GBP	0.484	0.471-0.484	0.464-0.544	0.505	0.48
JPY	97.8	90.2-97.8	61.3-97.8	79.4	93.9

The week ahead

NZ Jun ANZ business confidence

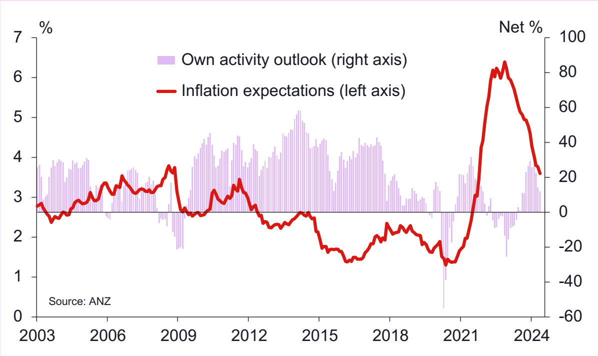
Jun 27, Last: 11.2

The May business outlook survey showed that the New Zealand economy remained in a soft patch. General business sentiment fell for a fourth straight month, with only a net 11% of firms confident about the outlook for the year ahead. Businesses' expectations for their own activity also fell, and have now effectively given back all of their post-election gains.

What was more encouraging was that the inflation gauges are pulling in the right direction. Expected inflation for the year ahead fell from 3.76% to 3.59%, the lowest reading since October 2021. Firms' pricing intentions remained elevated, but resumed their decline after having stalled for most of the last year.

Sentiment on the economy is likely to have stayed sour in June. However, the pricing gauges remain the key things to watch.

Business confidence

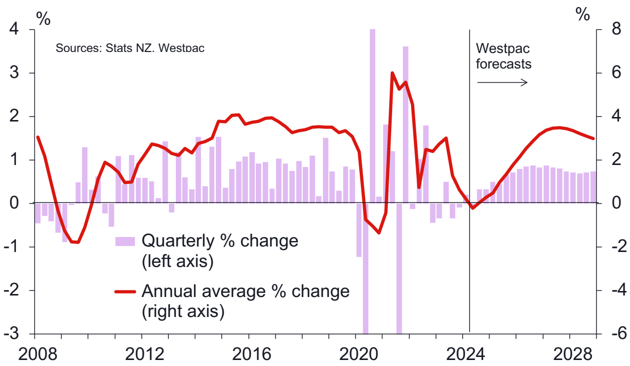


Economic and financial forecasts

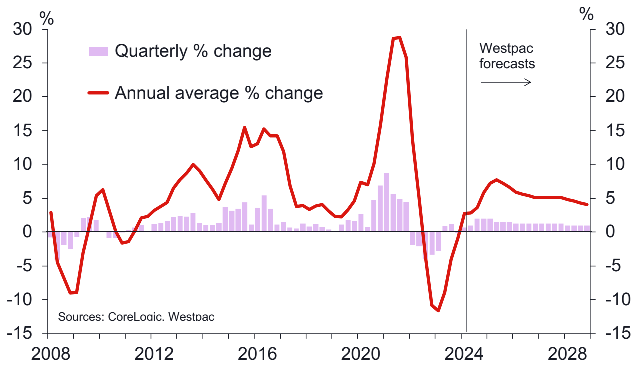
Economic indicators	Quarterly % change				Annual % change			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
GDP (production)	-0.1	0.2	-0.1	0.3	2.4	0.6	0.3	1.8
Consumer price index	0.5	0.6	0.6	1.1	7.2	4.7	2.8	2.2
Employment change	0.4	-0.2	0.2	0.1	1.7	2.7	0.1	0.9
Unemployment rate	4.0	4.3	4.6	4.9	3.4	4.0	5.2	5.4
Labour cost index (all sectors)	1.0	0.9	0.9	0.8	4.1	4.3	3.4	2.5
Current account balance (% of GDP)	-6.9	-6.8	-6.7	-6.5	-8.8	-6.9	-6.3	-4.1
Terms of trade	-7.8	4.6	1.9	1.3	-4.2	-10.6	8.1	0.8
House price index	-0.1	0.7	1.0	2.0	-10.8	-0.9	5.8	6.7

Financial forecasts	End of quarter				End of year			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
OCR	5.50	5.50	5.50	5.50	4.25	5.50	5.50	4.50
90 day bank bill	5.65	5.66	5.60	5.60	4.27	5.65	5.50	4.50
2 year swap	5.28	4.91	5.00	5.00	5.10	5.28	4.80	4.15
5 year swap	4.85	4.40	4.55	4.65	4.67	4.85	4.55	4.30
10 year bond	5.09	4.69	4.75	4.90	4.31	5.09	4.80	4.50
TWI	70.8	71.6	70.3	70.5	70.8	70.8	70.9	72.1
NZD/USD	0.60	0.61	0.60	0.60	0.60	0.60	0.61	0.65
NZD/AUD	0.93	0.93	0.91	0.91	0.92	0.93	0.91	0.91
NZD/EUR	0.56	0.56	0.55	0.55	0.59	0.56	0.55	0.57
NZD/GBP	0.49	0.48	0.47	0.47	0.51	0.49	0.48	0.49

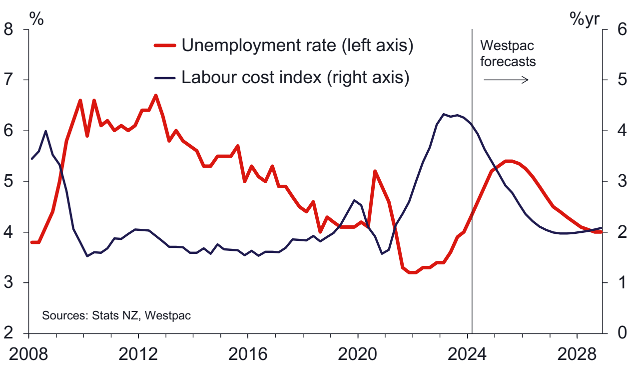
GDP growth



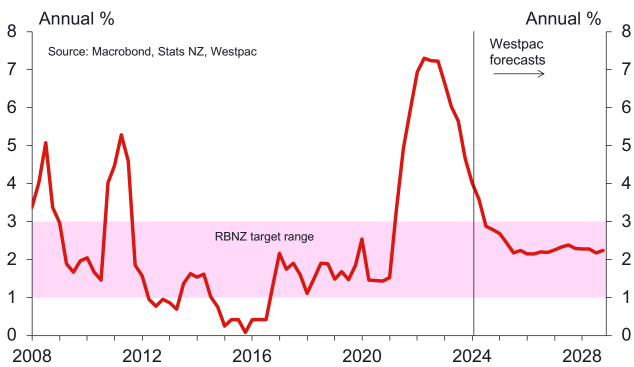
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 24					
NZ	May Trade Balance $mn	91	–	337	A small surplus likely as exports hit a seasonal peak.
US	Jun Dallas Fed Index	–19.4	–	–	Manufacturing conditions remain weak.
	Fedspeak	–	–	–	Waller, Daly.
Tue 25					
NZ	Q2 Westpac Employment Confidence	104.4	–	–	Job availability has been softening.
Aus	Jun Westpac-MI Consumer Sentiment	82.2	–	–	Still waiting on a decisive improvement in the inflation situation.
	Q2 ACCI-Westpac Business Survey	43.1	–	–	Conditions soured at the start of the year.
US	May Chicago Fed Activity Index	–0.23	–	–	Slack is building in the economy.
	Jun Consumer Confidence Index	102	100	–	Labour market critical to consumer outlook.
	Jun Richmond Fed Index	0	–	–	Manufacturing weak across the regions.
	Fedspeak	–	–	–	Cook, Bowman.
Wed 26					
Aus	RBA Assist' Governor (Financial Mkts)	–	–	–	Kent speaking at ABA Banking Conference.
	May Westpac–MI Leading Index	–0.01%	–	–	Stabilising after long run of weak reads.
	May Monthly CPI Indicator %yr	3.6%	3.8%	4.0%	Will provide some insight into services inflation.
US	May New Home Sales %mth	–4.7%	2.5%	–	Low inventories constraining sales.
Thu 27					
NZ	Jun ANZ Consumer Confidence	84.9	–	–	Household budgets remain under pressure.
	Jun ANZ Business Confidence	11.2	–	–	Confidence has given back all of its post–election bounce.
Aus	Jun MI Inflation Expectations %yr	4.1%	–	–	Medium-term inflation expectations remain well-anchored.
	Q2 Job Vacancies %qtr	–6.1%	–	–	Moderating from an elevated level, as labour market cools.
	RBA Deputy Governor	–	–	–	Hauser debut speech at Australian Economic Forum.
Chn	May Industrial Profits %yr	4.0%	–	–	Falling producer–gate prices a key drag on profitability.
US	Q1 GDP (annualised)	1.3%	1.5%	–	Final estimate.
	May Durable Goods Orders %mth	0.6%	0.0%	–	Uncertainty over outlook weighing on orders.
	Jun Kansas City Fed Index	–2	–	–	Manufacturing weak across the regions.
	May Wholesale Inventories %mth	0.1%	–	–	Firms are second guessing demand, limiting inventories.
	May Pending Home Sales %mth	–7.7%	–	–	Supply and affordability are both challenges.
	Initial Jobless Claims	238k	–	–	To remain low for now.
Fri 28					
NZ	Matariki Public Holiday	–	–	–	Markets closed.
Aus	May Private Sector Credit %mth	0.5%	0.4%	0.4%	Holding around a 5% annual pace.
Jpn	May Jobless Rate %	2.6%	2.6%	–	Labour market tightness unlikely to dissipate any time soon.
	Jun Tokyo CPI %yr	2.2%	2.3%	–	Waiting for evidence of a wage–price spiral.
	May Industrial Production %mth	–0.9%	2.0%	–	Auto delays are hampering production.
UK	Q1 GDP %qtr	0.6%	0.6%	–	Final estimate.
US	May Personal Income %mth	0.3%	0.4%	0.3%	Wages growth is moderating...
	May Personal Spending %mth	0.2%	0.3%	0.3%	... but services demand is holding up spending.
	May PCE Deflator %mth	0.3%	0.0%	0.1%	Any deviation from consensus will be closely scrutinised.
	Jun Chicago PMI	35.4	–	–	Manufacturing weak across the regions.
	Jun Uni. of Michigan Sentiment	65.6	–	–	Final estimate.
	Fedspeak	–	–	–	Barkin, Bowman.
Sun 30					
Chn	Jun NBS Manufacturing PMI	49.5	49.6	–	Broadly consistent with long–run average levels for industry.
	Jun NBS Non–Manufacturing PMI	51.1	–	–	Signs of optimism returning to a challenged services sector.

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